



EXEMPT AND
MENT ENTITIES
DIVISION

Date:

APR 4 2002

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NO PROTEST RECEIVED
Release to Manager, EO
DATE: 5/1/68

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Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

According to your Form 1023 Application, you were organized on [REDACTED] as a [REDACTED] nonprofit corporation. You described your purposes in a grant application as providing affordable farmland and housing and promoting sustainable economic agriculture. Your articles state the following particular purposes:

- (1) To protect the natural environment and to promote the ecologically sound use of land and natural resources and the long-term health and safety of the community.
- (2) To promote sustainable productive associations of local residential properties in order to develop and maintain community in area neighborhoods.
- (3) To promote local economic opportunities for residents of these neighborhoods by making land available for projects and activities that improve the quality of life in these neighborhoods, and by assisting residents of these neighborhoods in developing the safety and well-being of their community.
- (4) To promote access to farm and forest land and housing that is affordable, and to preserve the quality and affordability of such land and housing for future residents of the community.
- (5) To educate the general public about the historic significance of farm life and farming as well as the importance of high quality, locally produced food.

Your incorporators comprised [REDACTED] and [REDACTED]. Your initial board of directors comprised [REDACTED] (President), [REDACTED] and [REDACTED].

[REDACTED] and [REDACTED] Your current board comprises [REDACTED] (President), [REDACTED] and [REDACTED]

Your primary founder is [REDACTED] a farmer. [REDACTED] sold their [REDACTED]-acre farm to you for \$[REDACTED] in exchange for an interest-free note with payment deferred until they leave you. Your board and the land tenants agreed unanimously to the sale. You state that the sale price was slightly below fair market value even disregarding the interest-free loan. They also made an interest-free \$[REDACTED] loan to you in [REDACTED] to buy additional farmland from an unrelated buyer, including a house, barn, and [REDACTED] acres on [REDACTED] in [REDACTED]. You incurred \$[REDACTED] in debt on that purchase, which will be repaid from rents and contributions/grants.

You have leased [REDACTED] acres of your land to [REDACTED] by lease dated [REDACTED]. This lease superseded a lease to the [REDACTED] "Farm," formerly known as [REDACTED], a Community Supported Agriculture (CSA) business with farm shareholders ([REDACTED] members). CSA refers to farms that sell directly to local consumers rather than wholesalers. Farm has no formal governing documents and is not a legal entity. It is an informal arrangement in which consumers annually purchase a share of the farm's produce based on the cost of running the farm, including profit for farmers—thus, purchasers share in the farm's fortunes and misfortunes. The food producers mostly reside on the land and include a baker, a fruit grower, and vegetable grower, and a poultry producer. Producers receive payment directly from the shareholders for the products. Residents of the land or shareholders need not be part of Farm. In addition to farm produce, Farm produces arts and crafts. Farm also houses one-year farm apprentices working in an apprentice program. Farm includes two houses, barn, sugar house, blacksmith shop, pottery studio, portable poultry houses, and pond. You hope to acquire more adjacent farmland in future and decrease the percentage leased to Farm.

The lease to Farm was a [REDACTED]-year lease, for \$[REDACTED]/month plus costs (debt, taxes, insurance, administrative costs). The lease requires sustainable/organic agricultural and forestry practices, and gives the lessor the right to approve the lessee's farm management plan. You also have a [REDACTED]-year lease form for leasing housing and improvements to residents, for \$[REDACTED]/month plus costs. The land-use charges are intended to approximate fair rental value for the usable portion of the land, subject to use and environmental restrictions imposed by you, which reduce the value by about half. You will convey land-use rights so as to ensure affordable access to land and housing to low and moderate-income residents, and to promote sustainable use of lands and long-term health of the environment (horsepower, rotating crops, no chemicals, forest buffer strips). You deem all land to be environmentally significant. The lessee's consent is required for you to mortgage or sell the land, and sales will not occur except in extraordinary circumstances. However, you will encourage resident ownership of housing/improvements on the land. A tenant is required to resell housing or other improvements at his purchase/construction price plus inflation, to ensure affordability to low/moderate-income buyers (the lessor retains the right of first refusal to purchase improvements). A lessee can sell only to a "low- or moderate-income person" or an heir. You state that you will comply with the Rev. Proc. 96-32 standards for "low income" and

[REDACTED]

relief of the poor in your activity of leasing residential land. Currently, you receive about \$ [REDACTED] per month in "Land Use Charges" - 1/3 for [REDACTED] and related businesses, 1/3 [REDACTED] and related businesses, 1/6 [REDACTED] residence, 1/6 [REDACTED] residence.

In addition to leasing land subject to use and environmental restrictions, you will also conduct educational programs with the assistance of residents, farmers, apprentices, and other local educators. For example, you have been awarded a grant (pending recognition of exemption) to develop and implement a program for local high school agriculture students and Future Farmers of America members. Farm is currently visited by school students and other interested members of the public.

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, or certain other purposes; no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 513(a) of the Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization "operates exclusively" for 501(c)(3) purposes only if it engages primarily in activities that accomplish such purposes. It does not operate exclusively for 501(c)(3) purposes if more than an insubstantial part of its activities does not further such purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes under section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, an organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the

requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

Rev. Rul. 72-147, 1972-1 C.B. 147, held not exempt under section 501(c)(3) of the Code an organization formed to provide low income housing to families but giving preference for housing to employees of a farm proprietorship operated by the individual who created and controlled the organization. The organization constructed 10 rental units adjacent to the farm. Applicants for housing were given preference according to type of position and length of employment on the farm. All units were occupied by low income families, who all were regular employees of the farm. The individual paid the rent for the employees. The Service reasoned that the organization served the founder's private interests.

Rev. Rul. 76-204, 1976-1 C.B. 152, held exempt under section 501(c)(3) of the Code an organization that preserved ecologically significant land for the benefit of the public. The organization acquired the land by gift or purchase and either maintained the land itself with limited public access or transferred the land to a government conservation agency by outright gift or being reimbursed by the agency for its cost. To be constantly aware of the availability of significant undeveloped areas, the organization worked closely with government agencies and private organizations concerned with environmental conservation. The Service reasoned that environmental protection for the benefit of the public serves a charitable purpose.

Rev. Rul. 78-384, 1978-2 C.B. 174, held not exempt under section 501(c)(3) of the Code an organization that owned farmland and restricted its use to farming or other uses the organization deemed ecologically suitable, but was not operated to preserve ecologically significant land and did not otherwise establish that it served a charitable purpose. The organization stated that it benefited the public by restricting its land to uses compatible with the ecology of the area. The Service reasoned that public benefit from the organization's self-imposed restriction on its own land was too indirect and insignificant to establish a charitable purpose.

In Better Business Bureau v. United States, 316 U.S. 279 (1945), the Supreme Court held that an organization was not organized and operated exclusively for charitable purposes. The court stated that the presence of a single non-exempt purpose, if substantial in nature, will destroy exemption regardless of the number or importance of truly exempt purposes.

Dumaine Farms v. Commissioner, 73 T.C. 650 (1980), acq., 1980-2 C.B. 1 (issue whether operated exclusively for exempt purposes), nonacq., 1980-2 C.B. 2 (issue whether organized exclusively for exempt purposes), held exempt under section 501(c)(3) of the Code an organization that held land operated as an experimental and demonstration farm. The organization sought to experiment in and disseminate knowledge about improved methods of agriculture in combination with wildlife management conservation of natural areas, partly by demonstrating their economic

[REDACTED]

feasibility. The organization admitted that its land was ordinary farmland and not an ecologically significant undeveloped area such as swamp, marsh, forest, or other wilderness tract. The organization worked closely with public agencies and academic institutions in developing research plans. The court reasoned that the organization's activities furthered scientific and educational purposes, that commercial purposes were incidental, and that private benefit to the founder's commercial farming operations (which were not conducted on the organization's farmland) was no greater than to other local farmers.

Some of your activities further educational purposes. However, your primary activity appears to be the leasing of land (subject to environmental and other use restrictions) to individuals. The question is whether this activity furthers exclusively exempt purposes.

We find that this activity is not charitable on the ground of protecting the environment, as you have made no showing that the land is environmentally significant. The organization in Dumaine Farms is distinguishable, as that organization directly conducted experimental farming (rather than leasing its land to private farmers), and worked closely with public agencies and academic institutions in doing so.

Under appropriate circumstances, the leasing of farmland to low-income farmers may provide relief to the poor and underprivileged. However, under the facts presented, [REDACTED] and [REDACTED] and their farming businesses, appear to be the primary beneficiaries of the leases. They founded you and, until recently, controlled your board. We find the circumstances substantially similar to those described in Rev. Rul. 72-147, in which an individual created and controlled an organization that provided housing to low-income individuals that worked on his farm. Thus, we find that you are operated substantially for the purpose of benefitting the private interests of the [REDACTED] and [REDACTED] and not exclusively for the benefit of a charitable class of low-income farmers.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not

[REDACTED]

be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[REDACTED] T:EO:RA:T:2
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

[REDACTED] [REDACTED]